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SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-77931; File No. SR-ISEMercury-2016-07)

May 26, 2016

Self-Regulatory Organizations; ISE Mercury, LLC; Order Approving Proposed Rule Change
Related to Market Wide Risk Protection

I.   Introduction

On March 29, 2016, ISE Mercury, LLC (the "Exchange" or "ISE Mercury") filed with

the Securities and Exchange Commission ("Commission") pursuant to Section 19(b)(1) of the

Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to

introduce new activity-based risk protection functionality. The proposed rule change was

published for comment in the Federal Register on April 14, 2016.[3] No substantive comment

letters were received in response to this proposal.[4] This order approves the proposed rule

change.

II.   Description of the Proposed Rule Change

The Exchange proposed to introduce two activity-based risk protection measures that will

be mandatory for all members: (1) the "Order Entry Rate Protection," which prevents members

from entering orders at a rate that exceeds predefined thresholds,[5] and (2) the "Order Execution

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[1]   15 U.S.C. 78s(b)(1).

[2]   17 CFR 240.19b-4.

[3]   See Securities Exchange Act Release No. 77569 (April 8, 2016), 81 FR 22140
        ("Notice").

[4]   The Commission received one anonymous comment letter that read "[g]ood." See Letter
        from Anonymous, dated May 3, 2016.

[5]   The Exchange stated that it will initiate the Order Entry Rate Protection pre-open, but in a
        manner that allows members time to load their orders without inadvertently triggering the
        protection. The Exchange further noted that it will establish and communicate the precise
        initiation time via circular and prior to implementation. See Notice, supra note 3, at
        22141 n.4.

Rate Protection," which prevents members from <u>executing</u> orders at a rate that exceeds their predefined risk settings (together, "Market Wide Risk Protection"). The Exchange will announce the implementation date of the proposed rule in a circular to be distributed to members prior to implementation.[6]

Pursuant to proposed Rule 714(d), "Market Wide Risk Protection," the Exchange's trading system (the "System") will maintain one or more counting programs on behalf of each member that will track the number of orders entered and the number of contracts traded on ISE Mercury.[7] Members may also use multiple counting programs to separate risk protections for different groups established within the member.[8] The counting programs will maintain separate counts, over rolling time periods specified by the member, for each count of: (1) the total number of orders entered; and (2) the total number of contracts traded.[9]

According to the Exchange, members will have the discretion to establish the applicable time period for each of the counts maintained under the Market Wide Risk Protection, provided

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[6]   See Notice, <u>supra</u> note 3, at 22141.

[7]   Unlike similar risk protection measures available on ISE Mercury's affiliated exchanges, the Market Wide Risk Protection functionality for ISE Mercury will not apply cross-market to its affiliated exchanges. <u>Cf.</u>, <u>e.g.</u>, Securities Exchange Act Release Nos. 77489 (Mar. 31, 2016), 81 FR 20004 (Apr. 6, 2016) (SR-ISE-2016-08) (notice describing International Securities Exchange, LLC's Market Wide Risk Protection functionality); and 77488 (Mar. 31, 2016), 81 FR 20021 (Apr. 6, 2016) (SR-ISEGemini-2016-03) (notice describing ISE Gemini, LLC's Market Wide Risk Protection functionality). <u>See also</u> Notice, <u>supra</u> note 3, at 22141 n.6.

[8]   The Exchange stated that it will explain how members can go about setting up risk protections for different groups (<u>e.g.</u>, business units) in a circular issued to members. <u>See</u> Notice, <u>supra</u> note 3, at 22141 n.7.

[9]   <u>See</u> proposed Rule 714(d). The Exchange clarified that a member's allowable order rate for the Order Entry Rate Protection will be comprised of parameter (1), while the allowable contract execution rate for the Order Execution Rate Protection will be comprised of parameter (2). The Exchange further explained that contracts executed on the agency and contra-side of a two-sided crossing order will be counted separately for the Order Execution Rate Protection. <u>See</u> Notice, <u>supra</u> note 3, at 22141.

that the selected period is within minimum and maximum time parameters that will be established by the Exchange and announced via circular.[10] By contrast, the Exchange's proposal does not establish minimum or maximum values for the order entry or execution parameters described in (1) and (2) above. Nevertheless, the Exchange will establish default values[11] for the time period, order entry, and contracts traded parameters in a circular to be distributed to members. The Exchange represented that such default values will apply only to members that do not submit their own parameters for the Market Wide Risk Protection measures.[12]

Under proposed Rule 714(d), the System will trigger the Market Wide Risk Protection when it determines that the member has either (1) entered a number of orders exceeding its designated allowable order rate for the specified time period, or (2) executed a number of contracts exceeding its designated allowable contract execution rate for the specified time period.[13] If the member's thresholds have been exceeded, the Market Wide Risk Protection will be triggered and the System will automatically reject all subsequent incoming orders entered by the member on ISE Mercury. In addition, if the member has opted in to this functionality, the System will automatically cancel all of the member's existing orders.[14] The Market Wide Risk

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[10] See Notice, supra note 3, at 22141. The Exchange stated that it anticipated setting these minimum and maximum time parameters at one second and a full trading day, respectively. See id. at n.9.

[11] See proposed Rule 714(d); see also Notice, supra note 3, at 22141.

[12] See Notice, supra note 3, at 22141.

[13] Id.; see also proposed Rule 714(d)(1). Specifically, after a member enters or executes an order, the System will look back over the specified time period to determine whether the member has exceeded the relevant thresholds. See Notice, supra note 3, at 22141. In the Notice, the Exchange provided examples illustrating how the Market Wide Risk Protection functionality would work both for order entry and order execution protections. See Notice, supra note 3, at 22141-42.

[14] Proposed Rule 714(d)(2).

Protection will remain engaged until the member manually (e.g., via e-mail) notifies the Exchange to enable the acceptance of new orders.[15]

III.   Discussion and Commission Findings

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act[16] and rules and regulations thereunder applicable to a national securities exchange.[17] In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act, which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public interest.[18]

The Commission believes that the Exchange's proposed activity-based order protections will provide an additional tool to members to assist them in managing their risk exposure.[19] Specifically, the Commission believes that the Market Wide Risk Protection functionality may help members to mitigate the potential risks associated with entering and/or executing a level of orders that exceeds their risk management thresholds that may result from, for example,

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[15]   Proposed Rule 714(d)(3). Members who have not opted to cancel all existing orders under proposed Rule 714(d)(2), however, will still be able to interact with their existing orders entered before the Market Wide Risk Protection was triggered. For instance, such members may send cancel order messages and/or receive trade executions for those orders. Id.; see also Notice, supra note 3, at 22141.

[16]   15 U.S.C. 78f(b).

[17]   In approving these proposed rule changes, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

[18]   15 U.S.C. 78f(b)(5).

[19]   The Exchange currently provides members with limit order price protections that reject orders priced too far outside of the Exchange's best bid or offer. See ISE Mercury Rule 714(b)(2).

technology issues with electronic trading systems. Further, the Commission notes that other

exchanges have established risk protection mechanisms for members and market makers that are

similar in many respects to ISE Mercury's proposal.[20]

Proposed Rule 714(d) imposes a mandatory obligation on ISE Mercury members to

utilize the Market Wide Risk Protection functionality. The Commission notes that, although the

Exchange will establish minimum and maximum permissible parameters for the time period

values, members will have discretion to set the threshold values for the order entry and order

execution parameters. [21] If members do not independently set such parameters, they will be

subject to the default parameters established by ISE Mercury.[22] While the Commission believes

that the Exchange's proposed rule provides members flexibility to tailor the Market Wide Risk

Protection to their respective risk management needs, the Commission reminds members to be

mindful of their obligations to, among other things, seek best execution of orders they handle on

an agency basis and consider their best execution obligations when establishing parameters for

the Market Wide Risk Protection or utilizing the default parameters set by ISE Mercury.[23] For

example, an abnormally low order entry parameter, set over an abnormally long specified time

period should be carefully scrutinized, particularly if a member's order flow to ISE Mercury

contains agency orders. To the extent that a member chooses sensitive parameters, a member

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[20]   See, e.g., Miami International Securities Exchange, LLC Rule 519A ("Risk Protection
        Monitor"); BATS BZX Exchange, Inc. Rule 21.16 ("Risk Monitor Mechanism").

[21]   The Exchange has represented that it anticipates that the minimum and maximum values
        for the applicable time period will be initially set at one second and a full trading day,
        respectively, which the Commission believes gives members wide latitude in establishing
        the applicable time periods. See Notice, supra note 3, at 22141 n.9.

[22]   Proposed Rule 714(d).

[23]   See Securities Exchange Act Release No. 37619A (Sept. 6, 1996), 61 FR 48290, at 48323
        (Sept. 12, 1996) (Order Execution Obligations adopting release); see also Securities
        Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496, 37537–8 (June 29, 2005)
        (Regulation NMS adopting release).

should consider the effect of its chosen settings on its ability to receive a timely execution on marketable agency orders that it sends to ISE Mercury in various market conditions. The Commission cautions brokers considering their best execution obligations to be aware that the agency orders they represent may be rejected as a result of the Market Wide Risk Protection functionality.

As discussed above, ISE Mercury determined not to establish minimum and maximum permissible settings for the order entry and order execution parameters in its rule and indicated its intent to set a minimum and maximum for the time period parameters that provide broad discretion to members (i.e., one second and a full trading day, respectively).[24] In light of these broad limits, the Commission expects ISE Mercury to periodically assess whether the Market Wide Risk Protection measures are operating in a manner that is consistent with the promotion of fair and orderly markets, including whether the default values and minimum and maximum permissible parameters for the applicable time period established by ISE Mercury continue to be appropriate and operate in a manner consistent with the Act and the rules thereunder.

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[24] See Notice, supra note 3, at 22141 n.9; see also supra note 21.

IV.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[25] that the

proposed rule change (SR-ISEMercury-2016-07) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated

authority.[26]

Brent J. Fields
Secretary

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[25]   15 U.S.C. 78s(b)(2).

[26]   17 CFR 200.30-3(a)(12).

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